U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF CHIEF COUNSEL FOR ADVOCACY

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AUG 28 1992

Federal Communications Commission
Office of the Secretary

ORIGINAL
FILE

Before the
Federal Communications Commission
Washington, DC 20554

In the Matter of	)	
	)	
Regulatory Reform for	)	
Local Exchange Carriers	)	CC Docket No. 92-135
Subject to Rate of Return	)	
Regulation	)	

Comments of the Chief Counsel for Advocacy
of the United States Small Business Administration
on the Notice of Proposed Rulemaking

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August 28, 1992

No. of Copies rec'd 0+5
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EXECUTIVE SUMMARY

This proceeding had its genesis in a 1987 rulemaking that commenced a three year reexamination of the regulatory regime for local exchange carriers (LECs). The end result was the institution of incentive regulation for the largest LECs. The Commission, the Office of Advocacy, and other parties commented that the implementation of price caps presents unique problems for small telephone companies. Despite these problems, many small carriers wanted the benefits associated with incentive regulation under price caps. The Commission promised the institution of a separate proceeding to review incentive regulation for small telephone companies. On July 17, 1992, the Commission fulfilled its promise with the release of a notice of proposed rulemaking on Regulatory Reform for Local Exchange Carriers Subject to Rate-of-Return Regulation, CC Docket No. 92-135.

The Commission offers three options to reduce the regulatory burdens associated with conventional rate regulation: 1) some carriers can select an incentive plan that mirrors the price cap plan for the largest LECs; 2) other carriers will be able to file tariffs based on historic costs for a wider variety of rates; and 3) most carriers will face reduced regulatory burdens associated with their current status as members of pools operated by the National Exchange Carrier Association (NECA) (baseline regulation). In addition to these three alternatives, the

Commission requested that the NECA develop incentive-based plans for carriers that remain in its pools.

The Office of Advocacy strongly supports the initiatives of the FCC. Reduced regulation will lower costs to customers and enable small telephone companies to concentrate on service and investment in infrastructure. While our support is wholehearted for allowing the filing of historic cost tariffs on common line rates (the fixed local-loop costs) and for NECA's examination of incentive regulation, other parts of the notice give the Office of Advocacy pause. In particular, we believe that modifications and clarifications must be made to the optional incentive and baseline regulatory plans. Furthermore, the Office of Advocacy disputes the Commission's interpretation of the Regulatory Flexibility Act (RFA).

The Office of Advocacy is convinced that the optional incentive must be modified to further lighten the regulatory load, increase protection to the financial structure of LECs selecting this option, and ensure that new service is provided quickly and efficiently. We recommend: 1) that the filing requirements be reduced; 2) that companies need not leave both NECA pools to qualify for eligibility; 3) that the lower limit on the earnings band be raised to protect LECs against undue cost changes; 4) that carriers need not carry a heavy burden in requesting tariff changes when exogenous factors raise costs; 5) pricing of new services must not be based on the rates charge by LECs subject to price caps; and 6)more guidance be given on how to determine which LEC should be used as a benchmark in calculating the rate for new service. The Office of Advocacy also requests that the Commission make explicit as possible that this plan remains an optional plan and no LEC need select it.

In our discussions with representatives of small telephone companies, we found that many small LECs are comfortable with the baseline regulatory approach and are sufficiently risk averse to tread the unchartered waters of incentive regulation. Since the vast majority of small telephone companies are going to remain subject to conventional rate regulation, the Office of Advocacy believes that the Commission should have done more to reduce the regulatory load on these LECs. We recommend that the Commission: 1) permit LECs using baseline regulation to use prospective costs or historic costs or both; 2) modify the pricing of new services so that LECs can offer them on an economically viable basis; 3) provide guidance on determining which LEC must be used as the starting point for calculating the tariff on new services; and 4) not require a LEC to petition the FCC when a baseline carrier purchases an exchange from an incentive carrier and merges the exchanges.

The Office of Advocacy interprets the Regulatory Flexibility Act to give the Commission sufficient discretion to comply with that Act's analytical requirements without endangering its mission under the Communications Act of 1934. We also dispute the FCC'c characterization of small LECs as dominant in their field becuase one of the raisons d'etre of this rulemaking is to afford flexibility to carriers facing competition. If they face competition, the carriers are not dominant in their field and thus qualify as small business for purposes of the RFA. The Office of Advocacy is convinced that proper application of the analytical tools contained in the RFA will lead to further means of reducing the regulatory burden on small telephone companies. The FCC should perform a final regulatory flexibility analysis prior to the issuance of a final rule.

The goals of this proceeding are admirable. To ensure that they are met, small carriers must be given sufficient discretion to select a regulatory regime that best suits their financial structure and operating capabilities. The Commission has taken a bold first step. More needs to be done and the Office of Advocacy believes that our suggestions are a modest step in line with the FCC's action.

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I. *Introduction*

In 1987, the Federal Communications Commission (FCC or Commission) initiated a proceeding to reexamine the method of regulating the rates of dominant carriers.[1] In the Matter of Policy and Rules Concerning Rates for Dominant Carriers, Notice

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[1] The Communications Act of 1934, 47 U.S.C. §§ 151-609, authorizes FCC regulation of interstate telecommunication services to ensure that rates are just, reasonable, and non-discriminatory. *Id.* at § 201. A local exchange carrier (LEC) provides customers with the ability to originate calls within a local calling area, receive incoming calls, and obtain access to long-distance networks. The FCC regulates that portion of the LEC's service used in providing access to an interstate network. Access between LECs is provided through long-distance networks owned by interexchange carriers (IXCs).

In 1979, the Commission recognized that its prior regulatory framework needed adjustment to meet the expansion of IXC competition. In the first report in the Competitive Carrier docket, 77 F.C.C.2d 308, the Commission established two classes of carriers -- dominant and non-dominant. All LECs were and remain classified as dominant. Only one IXC, AT&T, is considered dominant and then only in certain areas.

of Proposed Rulemaking, CC Docket No. 87-313 (1987) (Price Cap Proceeding). That initial notice commenced a three year debate over the proper method for regulating dominant carriers. Specifically, the Commission replaced conventional cost-of-service regulation with price caps[2] for AT&T and the eight largest LECs. Four other LECs with more than 500,000 access lines also adopted price caps.

In our comments on the price cap proceeding, the Office of Advocacy concurred with the FCC's decision to make price caps optional for smaller carriers. We argued that electability would enable "companies to determine which regulatory method best suits their financial structure and the demands of their customers."[3] In subsequent comments, we noted the structure of price caps

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[2] Price caps represent a different method by which the FCC can ensure just, reasonable, and non-discriminatory rates. The touchstone of the price cap system is the imposition of price limits on baskets of related services rather than mandating a particular percentage rate-of-return. Within these baskets, LECs have wide, but not unfettered, discretion to price their services.

[3] Price Cap Proceeding, Second Further Notice of Proposed Rulemaking, Comments of the Office of Advocacy at 18 (June 16, 1989).

might discourage many Tier 2 LECs[4] and thereby denying their customers any benefits from price cap regulation.[5]

The FCC recognized that the imposition of price caps on larger LECs would have implications on smaller LECs. For example, the Commission noted that price caps may affect the contributions to revenue pools operated by the National Exchange Carrier Association (NECA) and the determination of costs for small carriers.[6] Irrespective of these problems, many smaller LECs voiced serious interest in regulatory reform and reductions in administrative burdens associated with the filing of tariffs. The Commission promised that it would examine these issues and regulatory relief options for small carriers.[7]

On July 17, 1992, the FCC fulfilled its promise and released a notice of proposed rulemaking to examine regulatory reform for

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[4] The FCC divides dominant LECs into two groups. Tier 1 LECs are those with annual revenue from regulated activities in excess of $100 million. These carriers account for the vast majority of all payments by IXCs to LECs for call completion and transport services yet represent less than 5% of all LECs. Tier 2 LECs are all other local carriers. Most of these serve rural areas with low-density populations, long distances between customers and central office switches, and have relatively high fixed costs per customer served.

[5] Price Cap Proceeding, Supplemental Notice of Proposed Rulemaking, Comments of the Office of Advocacy at 11 (May 7, 1990).

[6] Price Cap Proceeding, Second Report and Order, slip op. at ¶ 330 (Oct. 4, 1990).

[7] *Id.* at ¶ 331.

smaller LECs. In the Matter of Regulatory Reform for Local Exchange Carriers Subject to Rate of Return Regulation, CC Docket No. 92-135 (July 17, 1992) (NPRM). The Commission offers three new regulatory options for smaller carriers: 1) an optional incentive plan that mirrors price caps; 2) an expansion of the availability of historical cost tariffs for small LECs; and 3) an alteration of the rate-of-return regulation based on prospective costs. The FCC also requests that NECA examine means to increase the availability of incentive regulation for carriers in its pools.

The Commission, pursuant to the Regulatory Flexibility Act, 5 U.S.C. §§ 601-12 (RFA), certified that this rulemaking will not have a significant economic upon a substantial number of small entities. NPRM at ¶ 56. The FCC argued that the RFA only applies to small businesses and the definition of small business in the RFA does not include businesses dominant in their fields such as LECs.

The Office of Advocacy commends the Commission for examining alternatives to price caps that might bring benefits of incentive-type regulation to small LECs and their customers. The Office also supports the FCC's call for NECA to develop incentive regulation alternatives for its pool members. We also support the expansion of the availability of historical cost tariffs to include common line rates. However, the Office of Advocacy does have some concerns that need to be addressed pertaining to the incentive option and the baseline rate-of-return method.

Finally, the Office of Advocacy disagrees with the Commission's certification pursuant to the RFA. In particular, we believe that smaller LECs are not dominant in their provision of telecommunication services for businesses and IXCs.

II. *The Optional Incentive Plan*

Conventional regulation of LECs starts with the determination of a rate-of-return through the Commission's represcription proceeding.[8] This rate-of-return is then used to calculate a tariff for various services that will earn the LEC the prescribed rate-of-return.[9] LECs cannot modify prices for their services because that change would alter the permissible rate-of-return. Nor do LECs have any incentive to lower costs because that translates into a higher percentage rate-of-return if tariff prices remain constant. If costs fall, the Commission requires a modification to the tariff so as not to exceed the prescribed rate-of-return.

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[8] In the Matter of Amendment of Parts 65 and 69 of the Commission's Rules to Reform the Interstate Rate-of-Return Represcription and Enforcement Processes, CC Docket No. 92-133 (July 14, 1992). The Office of Advocacy expects to file comments in that proceeding.

[9] The tariffs are designed to recover the LECs' costs and provide them with a fair return on its investment.

The optional incentive plan would modify this structure. It would commence with the rate-of-return established in the represcription proceeding and tariffs designed to meet that target. In the incentive option proposed by the FCC, a LEC that lowered its costs would not have to modify its prices to maintain the prescribed rate-of-return. Rather, it could retain those earnings irrespective of the actual rate-of-return. Similarly, if the carrier could not lower costs sufficiently and its rate-of-return went below the prescribed level, it could not raise prices to reach the prescriber rate-of-return.

The optional incentive plan would not permit limitless increases or decreases in the rate-of-return earned by the LEC. The Commission would establish upper and lower limits. If the LEC's earnings exceeded the upper level, the FCC would mandate a reduction in prices. On the other hand, the Commission would authorize an increase in prices if the carrier's rate-of-return fell below the lower limit.

The FCC would deem any price changes between the upper and lower limits to be just and reasonable. This would give the LECs discretion in pricing services and significantly reduce the potential that their rates would be suspended.[10]

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[10] Under § 208 of the Communications Act, the FCC is authorized, on its own motion or at the request of any interested party, to suspend the operation of a particular tariff and investigate whether the tariff is just, reasonable, and non-
(continued...)

Rates-of-return and associated tariffs would be filed biennially. Subsequent prescriptions of the rates-of-return would be based on the costs actually incurred by the LEC in the prior filing period and any known future costs.[11]

The Office of Advocacy remains unconvinced that incentive regulation provides the benefits claimed for it by the Commission. Nevertheless, the Office of Advocacy recognizes LECs must be given some enticement to lower costs and discretion to modify prices to meet the competition in the provision of interstate access services. In addition, the Office of Advocacy supports efforts to reduce the regulatory burdens on small LECs because lower costs will redound to the benefits of customers.

The Office of Advocacy has evaluated the incentive option and believes that further clarification of some issues are necessary. Furthermore, to the extent that customers benefit from incentive regulation, the Office of Advocacy believes that regulatory scheme should impose the least burdens necessary for the Commission to satisfy its statutory obligations.

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[10](...continued) discriminatory. The incentive plan, like price cap regulation, would require the party seeking suspension, including the Commission, to bear a heavy burden in demonstrating the tariff violates § 201(b) if it meets the conditions of the plan.

[11] Such costs might include replacement of equipment damaged from a storm or upgraded because it has been fully depreciated.

A. Eligibility

The optional incentive plan is only available to those companies that are not currently subject to price caps and not members of any NECA pool. This description currently fits approximately 50 LECs. Others, most them very small, are eligible if they drop out of the NECA pools.

The vast majority of smaller LECs are well-run, extremely efficient providers of sophisticated[12] telecommunications services. Their small size and efficiency make it well nigh impossible for them to reduce, maintain service quality, and benefit from incentive regulation.

Nothing in the incentive plan forces us to retreat from our comments in previous rulemakings that small LECs should have the discretion to select the regulatory option that best suits their needs. The FCC must remove any doubt that the optional incentive regulation is just that -- optional. No small LEC, i.e., one

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[12] In most cases, independent LECs provide better service, more digital switches, and increased deployment of fiber in their service areas than the Regional Bell Operating Companies provide in their rural areas. Comments of Cheryl Tritt, Chief Common Carrier Bureau at FCC open meeting June 18, 1992.

with less than 50,000 access lines,[13] must be forced into this plan.

After discussions with groups representing small LECs, the Office of Advocacy is convinced that only a few companies will exit the NECA pools and select optional incentive regulation. Nevertheless, the Commission, in its zealous quest for incentive-based regulation, might make the plan sufficiently attractive to induce carriers currently in the one or both pools[14] to exit them. Such defections will have a tremendous adverse impact on the companies that remain in the pools. In turn, this will seriously inhibit the function of the pools -- to provide resources to ensure that LECs with high common line costs have

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[13] In 1986, at the urging of the United States Telephone Association, the National Telephone Cooperative Association, and the Office of Advocacy, the FCC reduced the administrative burdens on telephone companies with less than 50,000 access lines. In the Matter of Regulation of Small Telephone Companies, CC Docket No. 86-467, Report and Order, 2 FCC Rcd 3811 (1987) (Small Telephone Company Proceeding). The Commission uses that figure as guide in ensuring that the special needs of smaller LECs are considered in its rulemakings. *E.g.*, In the Matter of Transport Rate Structure and Pricing, CC Docket No. 91-213, Further Notice of Proposed Rulemaking, slip op. at ¶ 39 (August 30, 1991); Price Cap Proceeding, Second Report and Order, slip op. at ¶ 411 (Oct. 4, 1990).

[14] NECA operates two pools. One is for traffic-sensitive costs and the other is for common line costs. Common line costs are those costs which do not vary with the amount of traffic and in rural areas usually is the cost of the local loop from the customer to the central office.

sufficient resources to provide service.[15] The Office of Advocacy requests that any incentive-based plan will not adversely affect the operation of the NECA pools.

Additionally, the Commission may wish to consider revising the optional incentive plan to eliminate the requirement that LECs must exit both pools. The Office of Advocacy believes that most carriers will not take the risk associated with leaving the common line pool and this will unduly limit the number of carriers willing to select incentive regulation. Moreover, this alternative may meet the Commission's goal of promoting incentive regulation within the confines of the NECA pools. *See* NPRM at ¶ 47.

B. Reporting Requirements

In the Small Telephone Company Proceeding, the FCC determined that the abatement of some paperwork requirements would lower the cost of service without jeopardizing the ability

[15] One basic goal of the Communications Act is to foster the development of universal telephone service. If LECs serving rural areas with low-density populations and high fixed-costs had to charge rates sufficient to recover the costs, rates for many subscribers would force them to abandon their service. The NECA pools, by aggregating revenue from LECs with varying costs, provides assistance to those LECs with high costs and enables them to lower their rates. This process helps achieve universal service.

of the Commission to ensure just, reasonable, and non-discriminatory rates. The Office of Advocacy believes that the rationale delineated in that proceeding applies with equal vigor to the information collection requirements in the optional incentive plan.

Current regulations require LECs currently eligible for incentive regulation to file tariffs annually with the Commission. The Office of Advocacy believes that biennial filings, as proposed in the NPRM, will permit adequate scrutinization of incentive-based rates. Moreover, the biennial filings will abate the truly burdensome aspect of tariff filings -- the collection and submission of supporting cost data.

While less frequent filings generally benefit the LEC and lower the cost of service, circumstances may arise in which a tariff filing must be revised prior to expiration. The FCC suggests that a LEC will have a heavy burden in proving the need to modify rates in those cases. NPRM at ¶ 10. The Office of Advocacy disagrees with this requirement.

Certain circumstances often are beyond the control of the LEC. For example, the FCC currently is considering serious modifications to the pricing of interstate transport. These proposed changes may force a serious migration from revenue enriching common transport to dedicated transport and its lower revenue.[16] LECs, especially smaller ones, have little ability to control the amount of traffic each IXC has or its decision to use common or dedicated transport. Similarly, weather-related occurrences can have a precipitous effect on the revenues and costs of small LECs.

In either case and similar circumstances, LECs and their customers should not suffer while awaiting termination of the tariff at the end of the biennial period. The Commission must allow LECs to request tariff modifications for exogenous circumstances without requiring any special burden of proof to be met.[17] The Office of Advocacy believes that the Commission must not adopt an onerous burden for modifying the tariff in cases of exogenous changes beyond the control of the LEC.

In their zeal to lower costs, LECs may allow service to deteriorate. The Commission requires all price cap carriers to file quarterly service quality reports and annual infrastructure reports. The FCC proposes that incentive regulation carriers also file quarterly service quality reports but file infrastructure reports every two years coetaneous with their

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[16] *See* In the Matter of Transport Rate Structure and Pricing, CC Docket No. 91-213, Comments of the Office of Advocacy at 16-19 (October 29, 1991).

[17] This is not significantly different than excluding exogenous costs in calculating the a price cap index for those LECs subject to that form of regulation.

tariffs. *Id.* at ¶ 21. These reports enable the Commission to monitor the LECs and ensure that their service quality and investment in new technology is not lost to the drive for lower costs and higher rates-of-return.

The Office of Advocacy does not dispute the need for oversight to ensure that the LECs do not use the incentive regulation plan to lessen their ability to provide customers with service. The Office of Advocacy has no cavil with the infrastructure reporting requirement. However, the Office of Advocacy strongly objects to the quarterly service reports and believes that fewer of such reports will serve the purposes of the Commission.

First, many of the small LECs, as the Commission notes, face competition from other LECs in abutting service areas. *Id.* at ¶ 17. Most IXCs and large users of interexchange service require very high quality service. Deterioration in service quality will lead large users to bypass their local LEC and have an adjacent LEC provide the needed transport services.[18] Given the fact that a large user may represent a substantial revenue source, the smaller LEC has a significant motivation to provide high quality service and retain that customer. The Office of Advocacy doubts that LECs selecting the incentive plan will allow service quality

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[18] This type of encroachment was approved in Public Utility Comm'n v. FCC, 886 F.2d 1325 (D.C. Cir. 1989).

to deteriorate to the point that they risk losing an important portion of their customer base.[19] The potential competition vitiates the need for service quality reports as frequently as those mandated for LECs operating under price caps.

Second, reporting requirements may dissuade LECs from selecting the incentive plan. The Commission notes that reporting and paperwork mandates may be particularly costly and onerous for small telephone companies. *Id.* at ¶ 30. Many LECs may determine that costs of complying with the optional incentive plan outweigh any benefits to be derived from pricing flexibility and a higher rate-of-return. Therefore, the Office of Advocacy recommends that the Commission revise the reporting requirements to reduce costs on those LECs selecting incentive regulation.[20]

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[19] The loss of a large user of interexchange service such as a bank will have little impact on Bell Atlantic with 16 million customers. However, the impact may be severe to the independent telephone company that serves Sleepy Eye, Minnesota -- a town with 3,500 people.

Since one particular customer usually represents only a fraction of the total business of a price cap LEC, they may have a greater ability to stint on service quality in order to reap the higher rates-of-return available under price caps. Therefore, they should be required to provide more frequent service quality reports.

[20] The Commission may wish to consider a tiered approach to service quality reporting with larger LECs reporting more frequently and smaller LECs submitting fewer reports.

C. Earnings Band

The Commission proposes that all revenue yielding earnings 100 basis points above and 100 basis points below the prescribed rate-of-return be retained by the LECs selecting the optional incentive plan. Carriers' prices within this band will be considered just and reasonable. Companies will have to carry a heavy burden of proof to make mid-course corrections if they fall below the prescribed rate-of-return but not outside the earnings band.

While the Office of Advocacy strongly criticized a similar approach in other Commission rulemakings,[21] we understand the need to protect smaller carriers against the substantial risk associated with incentive regulation. The Office of Advocacy generally backs the encasement of incentive regulation within the integument of rate-of-return regulation for smaller LECs. However, the Office of Advocacy is concerned by the lower band limit for determining just and reasonable prices.

In some cases the lower band limit may make it difficult for a LEC to meet competition from an adjoining LEC or a competitive

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[21] Price Cap Proceeding, Supplemental Notice of Proposed Rulemaking, Comments of the Office of Advocacy at 12-14 (May 7, 1990); Second Further Notice of Proposed Rulemaking, Comments of the Office of Advocacy at 19-22 (June 16, 1989).

access provider.[22] The FCC must ensure that LECs facing competition, from whatever source, need not bear a heavy burden in demonstrating the need to revise their tariff filings prior to the two-year expiration date.[23]

The lower band limitation also represents a concern for LECs that do not face transport service competition. Modest increases in costs may result in rates-of-return less than the prescribed rate but higher than the proposed lower band limit. The reduction in the rate-of-return will hurt the capitalization efforts of these LECs and raise their debt costs. This adverse effect on the financial structure of LECs may compel them to avoid incentive regulation or reduce investment in new technology. We suspect that neither result will satisfy the FCC.

The Office of Advocacy suggests that a reduction in the lower level to 50 basis points below the prescribed rate-of-return will give the smaller LECs greater assurance that their financial structure will be protected under the incentive option. This added protection may induce more LECs to select the

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[22] Competitive access providers supply interexchange carriers and large users of telecommunication services with transport services normally furnished by LECs. Most competitive access providers operate in large urban areas and only a few LECs eligible for the optional incentive regulation face such competition. Nevertheless, these few companies will need some pricing flexibility to meet competition for transport services.

[23] The FCC must be extremely vigilant in ensuring that the pricing flexibility is not transformed into a weapon of anticompetitive predation.

incentive plan without endangering their ability to provide service at a reasonable price.

D. The Pricing of New Services

When a LEC introduces a new service, there is no historical basis for determining the cost for providing that service and the rate needed to recoup those costs. Under the optional incentive plan, rates for new services are derived from the rates charged by the geographically closest price cap LEC. *Id.* at ¶ 16. The Office of Advocacy opines that this procedure is both illogical and unworkable.

The FCC notes that small carriers may not be able to "gain economies of scale and scope that could spread the risks associated with price caps over a greater economic base." *Id.* at ¶ 8. Despite the Commission's recognition that these smaller carriers may not be able to gain the pricing efficiencies available to price cap carriers, the FCC still suggests that the pricing of new services be based on the rates charged by these larger LECs. Under these circumstances, a LEC may calculate that it cannot afford to offer the new service under the rate charged by the price cap carrier. The LEC customer then is condemned to inferior service by regulatory fiat or forced to seek an alternative provider of the service -- most likely the closest price cap carrier. This migration and encroachment further erodes the limited customer base of small LECs. Ultimately, universal service and other goals of the Communications Act may be threatened in these service territories. The Office of Advocacy recommends that the Commission adopt a policy designed to foster the implementation of new technologies and choose some other basis for calculating rates for new services.

Even assuming smaller LECs can afford to offer the service, the proposal must be clarified. In many circumstances it may be difficult to determine which price cap LEC is geographically closest. The Commission must specify how the determination will be made so that carriers can avoid unnecessary costs associated with § 208 suspension proceedings.

E. Summary

The Office of Advocacy supports incentive regulation to the extent that its implementation can provide benefits to the customers of LECs. To ensure that the full extent of these advantages redound to LECs and their customers, the Office of Advocacy recommends that the Commission reexamine the proposed plan and modify those portions that will unnecessarily raise costs to incentive plan LECs. The Commission should consider using the analytical tools of the RFA to examine the best methods for establishing incentive regulation.

III. *Baseline Rate of Return Regulation*

The Commission also recognizes the need to ameliorate the regulatory burdens on LECs that do not select the optional incentive regulation plan. The Commission understands that this reduction in the regulatory burdens will be beneficial to the vast majority of Tier 2 LECs. The Office of Advocacy fully backs this effort by the FCC.

Current regulations require all carriers not regulated under price caps to file tariffs with the FCC every year or have NECA file the tariffs. Certain small LECs may file traffic sensitive rates every other year. *Id.* at ¶ 38. Tariff filings must be backed by cost data; the depth of detail depends upon the size of the LEC with larger LECs required to supply more information. Even the least detailed category still requires an inordinate amount of cost accounting and other economic data. The Commission refers to this regulatory regime as baseline rate-of-return regulation. The FCC tentatively concludes that this burden is excessive and unnecessary. *Id.* at ¶ 42.

The Office of Advocacy strongly agrees and commends the Commission for undertaking this effort. The Office of Advocacy concurs with the FCC finding that biennial filings of tariffs will not impede its statutory mission. The Office of Advocacy also subscribes to the Commission position that small carriers need streamlined[24] regulation to compete and provide new technologies to their customers. These regulatory changes will permit LECs to concentrate their efforts on providing state-of-the-art telecommunication services rather than complying with various governmental edicts.

The Office of Advocacy's overall enthusiasm for the Commission proposal is buffered by the inclusion of three proposals that, in our view, seriously weakens the effort to remove the regulatory shackles from LECs subject to baseline regulation. First, the FCC proposes to use extrapolations of historical cost to support tariff filings. Second, the Commission will not permit streamlined treatment of new services unless the rate is no higher than that of a neighboring LEC offering the same service. Third, the Commission proposes to require LECs to seek the approval of the FCC prior to merging any exchanges purchased from an incentive-regulated carrier.

A. Historical Cost

The FCC's effort to reduce the burden of supplying cost information is misplaced. The Commission relies on the concept that costs and investment tend to fairly predictable. The Office

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[24] Under the Commission's definition of streamlined regulation, tariffs that meet specific conditions are unlikely to be suspended and investigated for reasonability pursuant to § 208.